

EVERCORE ISI

Energy | Power & Utilities

May 07, 2020

Essential Utilities Inc.

WTRG | \$40.59

In Line | TARGET PRICE: \$38.00 (from \$37.00)

Earnings Report

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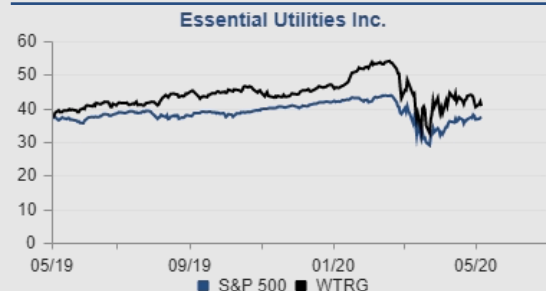
Company Statistics

Market Capitalization (M)	\$8,597
Shares Outstanding (M)	223
Dividend	0.95
Dividend Yield	2.5%
Payout Ratio	61.2%
Expected Total Return	1.2%
Fiscal Year End	Dec

Earnings Summary

	2020E	2021E	2022E
EPS	\$1.55	\$1.65	\$1.80
P/E	24.8	23.3	21.3
EPS vs Consensus	(0.8)%	0.2%	1.9%
Consensus EPS	\$1.57	\$1.65	\$1.77
Consensus P/E	24.6	23.3	21.8

1 Year Price History



Good quarter, 2020 & LT EPS Targets Reaffirmed

WTRG reported Q1 '20 Adjusted EPS of \$0.60 versus consensus of \$0.58. The company booked \$0.02 EPS uplift from repairs pass-through in the quarter in line with original guidance of \$0.08 - \$0.12 EPS benefit for the year. There could be further potential earnings upside if the commission allows favorable treatment of the legacy tax balance (not in our forecast). Essential also reaffirmed its 2020 EPS guidance range of \$1.53-\$1.58 and still projects EPS to grow in the range of 5-7% on average from 2019 through 2022. The company filed for Delcora waste water acquisition approval with the commission in the first quarter and still expects to issue \$300MM in equity later this year to finance the deal (\$0.03 EPS contribution included in our forecast). They are closely monitoring COVID-related implications on consumption, collections and capital expenditures and based on current available information don't expect a material financial impact to 2020 EPS.

Target Price \$38, rating still In Line. We are maintaining our EPS estimates which incorporate company guidance issued at analyst day earlier in the year. Our '20/'21/'22 EPS forecast of \$1.55/\$1.65/\$1.80 drives a '19 through '22 CAGR of ~7% towards the high end of company's targeted EPS growth rate of 5-7%. Our \$38 target price is based on a SOTP where we assign 23.0x P/E to the earnings contribution from the legacy water business and ~17x to earnings from the gas segment. The 23.0x water P/E is in line with our water regulated peer average target multiple. The gas multiple of ~17x is also in line with current gas LDC trading valuation multiples. Rating remains In Line

Repairs Tax Election Uplift, 8-12c/yr. Essential's 2020 and forward looking EPS guidance includes 8-12c/share annual earnings uplift which is more/less in line with our estimate of ~10c. There may be additional accretion from historical balances pending commission review and final decision. For context, in 2012, Aqua (water utility) changed its tax method of accounting for qualifying utility asset repairs in PA. The tax accounting method was changed to permit the expensing of certain utility asset repairs/maintenance costs that were previously being capitalized and depreciated for tax purposes. The company used flow-through accounting for the tax benefits of the repair tax accounting change per the Pennsylvania rate order from June '12. The flow-through accounting implementation resulted in a reduction in the company's effective income tax rate, which in turn lowered income tax expense and increased net income. WTR's effective tax rate was materially lower than the statutory tax rate at (7.7%) / 6.6% / 8.2% for the years '18 / '17 / '16 respectively. Higher earnings power supported higher returns on equity, which allowed Aqua to invest over \$2bn of capital on system improvements over the past seven years without having to go in for rate cases in PA. There could be further earnings upside (~\$0.05 annual EPS uplift by our estimate) if the commission allows favorable treatment of the legacy tax balance.

VALUATION METHODOLOGY

Our \$38 target price is based on a SOTP where we assign 23.0x P/E to the earnings contribution from the legacy water business and ~17x to earnings from the gas segment. The 23.0x water P/E is in line with our water regulated peer average target multiple. The gas multiple of ~17x is also in line with current gas LDC trading valuation multiples.

RISKS

Risks to our thesis include an unfavorable regulatory outcome leading to lower rate base growth and/or lower allowed or earned ROEs in ongoing and future rate cases. Other risks include exposure to unusual weather, impact of conservation awareness of customers and more efficient plumbing fixtures and appliances on water usage per customer, cyber security and water contamination.

COMPANIES UNDER COVERAGE BY AUTHOR

Symbol	Company	Rating	Price (2020-07-05)	Evercore ISI Target
AEE	Ameren Corp.	Outperform	\$69.95	\$84.00
AEP	American Electric Power	Outperform	\$78.79	\$95.00
AES	The AES Corporation	Outperform	\$12.14	\$20.00
AGR	Avangrid Inc	In Line	\$41.88	\$46.00
AWK	American Water Works Company, Inc.	Outperform	\$119.25	\$118.00
AWR	American States Water Company	Underperform	\$74.17	\$60.00
CMS	CMS Energy Corp.	In Line	\$54.52	\$63.00
CNP	CenterPoint Energy, Inc.	In Line	\$17.75	\$17.00
CWEN	Clearway Energy	In Line	\$20.48	\$20.00
CWT	California Water Service Group	In Line	\$45.10	\$46.00
D	Dominion Energy, Inc	In Line	\$78.22	\$82.00
DTE	DTE Energy Co.	In Line	\$99.18	\$120.00
DUK	Duke Energy Corp.	In Line	\$80.51	\$90.00
ED	Consolidated Edison Inc.	In Line	\$74.53	\$86.00
EIX	Edison International	In Line	\$54.78	\$80.00
ES	Eversource Energy	In Line	\$77.90	\$91.00
ETR	Entergy Corp.	In Line	\$93.08	\$106.00
EVRG	Evergy	In Line	\$56.15	\$64.00
EXC	Exelon Corp.	Outperform	\$35.07	\$49.00
FCFE18-MX	CFE Capital S. de R.L. de C.V.	Outperform	MXN19.30	MXN19.00
FE	FirstEnergy Corp.	Outperform	\$40.26	\$50.00
HE	Hawaiian Electric Industries Inc.	Underperform	\$36.72	\$36.00
NEE	NextEra Energy Inc	In Line	\$226.04	\$249.00
NI	NiSource Inc	Outperform	\$22.97	\$28.00
NRG	NRG Energy Inc.	Outperform	\$32.13	\$47.00
OGE	OGE Energy Corp	Outperform	\$29.30	\$35.00
PCG	PG&E Corp.	Rating Suspended	\$11.15	
PEG	Public Service Enterprise Group	In Line	\$47.94	\$53.00
PNM	PNM Resources, Inc	In Line	\$38.39	\$44.00
PNW	Pinnacle West Capital Corp.	In Line	\$72.05	\$85.00
PPL	PPL Corp.	In Line	\$24.36	\$31.00
SJW	SJW Group	In Line	\$58.61	\$65.00
SO	Southern Co.	In Line	\$54.33	\$59.00
SRE	Sempra Energy	Outperform	\$123.91	\$138.00
VST	Vistra Energy Corp	Outperform	\$17.95	\$32.00
WEC	WEC Energy Group, Inc.	In Line	\$85.36	\$93.00
WTRG	Essential Utilities Inc.	In Line	\$40.59	\$38.00
XEL	Xcel Energy Inc.	In Line	\$60.06	\$65.00

TIMESTAMP

(Article 3(1)e and Article 7 of MAR)

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Current Ratings Definition

Evercore ISI's recommendations are based on a stock's total forecasted return over the next 12 months. Total forecasted return is equal to the expected percentage price return plus gross dividend yield. We divide our stocks under coverage into three primary ratings categories, with the following return guidelines:

Outperform- the total forecasted return is expected to be greater than the expected total return of the analyst's coverage universe

In Line- the total forecasted return is expected to be in line with the expected total return of the analyst's universe

Underperform- the total forecasted return is expected to be less than the expected total return of the analyst's universe

Coverage Suspended- the rating and target price have been removed pursuant to Evercore ISI policy when Evercore is acting in an advisory capacity in a merger or strategic transaction involving this company and in certain other circumstances.*

Rating Suspended- Evercore ISI has suspended the rating and target price for this stock because there is not sufficient fundamental basis for determining, or there are legal, regulatory or policy constraints around publishing, a rating or target price. The previous rating and target price, if any, are no longer in effect for this company and should not be relied upon.*

*Prior to October 10, 2015, the "Coverage Suspended" and "Rating Suspended" categories were included in the category "Suspended."

FINRA requires that members who use a ratings system with terms other than "Buy," "Hold/Neutral" and "Sell" to equate their own ratings to these categories. For this purpose, and in the Evercore ISI ratings distribution below, our Outperform, In Line, and Underperform ratings can be equated to Buy, Hold and Sell, respectively.

Historical Ratings Definitions

Prior to March 2, 2017, Evercore ISI's recommendations were based on a stock's total forecasted return over the next 12 months:

Buy- the total forecasted return is expected to be greater than 10%

Hold- the total forecasted return is expected to be greater than or equal to 0% and less than or equal to 10%

Sell -the total forecasted return is expected to be less than 0%

On October 31, 2014, Evercore Partners acquired International Strategy & Investment Group LLC ("ISI Group") and ISI UK (the "Acquisition") and transferred Evercore Group's research, sales and trading businesses to ISI Group. On December 31, 2015, the combined research, sales and trading businesses were transferred back to Evercore Group in an internal reorganization. Since the Acquisition, the combined research, sales and trading businesses have operated under the global marketing brand name Evercore ISI.

ISI Group and ISI UK:

Prior to October 10, 2014, the ratings system of ISI Group LLC and ISI UK which was based on a 12-month risk adjusted total return:

Strong Buy- Return > 20%

Buy- Return 10% to 20%

Neutral - Return 0% to 10%

Cautious- Return -10% to 0%

Sell- Return< -10%

For disclosure purposes, ISI Group and ISI UK ratings were viewed as follows: Strong Buy and Buy equate to Buy, Neutral equates to Hold, and Cautious and Sell equate to Sell.

Evercore Group:

Prior to October 10, 2014, the rating system of Evercore Group was based on a stock's expected total return relative to the analyst's coverage universe over the following 12 months. Stocks under coverage were divided into three categories:

Overweight- the stock is expected to outperform the average total return of the analyst's coverage universe over the next 12 months.

Equal-Weight- the stock is expected to perform in line with the average total return of the analyst's coverage universe over the next 12 months.

Underweight -the stock is expected to underperform the average total return of the analyst's coverage universe over the next 12 months.

Suspended- the company rating, target price and earnings estimates have been temporarily suspended.

For disclosure purposes, Evercore Group's prior "Overweight," "Equal-Weight" and "Underweight" ratings were viewed as "Buy," "Hold" and "Sell," respectively.

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Evercore ISI utilizes an alternate rating system for companies covered by analysts who use a model portfolio-based approach to determine a company's investment recommendation. Covered companies are included or not included as holdings in the analyst's Model Portfolio, and have the following ratings:

Long- the stock is a positive holding in the model portfolio; the total forecasted return is expected to be greater than 0%.

Short- the stock is a negative holding in the model portfolio; the total forecasted return is expected to be less than 0%.

No Position- the stock is not included in the model portfolio.

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Stocks included in the model portfolio will be weighted from 0 to 100% for Long and 0 to -100% for Short. A stock's weight in the portfolio reflects the analyst's degree of conviction in the stock's rating relative to other stocks in the portfolio. The model portfolio may also include a cash component. At any given time the aggregate weight of the stocks included in the portfolio and the cash component must equal 100%.

Stocks assigned ratings under the alternative model portfolio-based coverage system cannot also be rated by Evercore ISI's Current Ratings definitions of Outperform, In Line and Underperform.

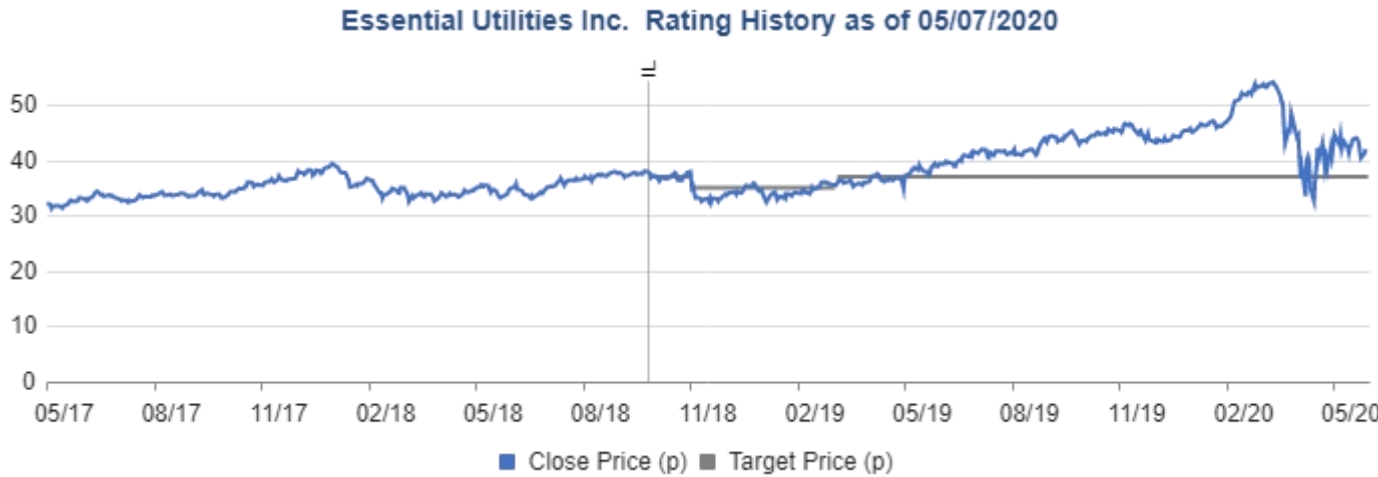
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Evercore ISI rating (as of 05/07/2020)

Coverage Universe			Investment Banking Services I Past 12 Months		
Ratings	Count	Pct.	Ratings	Count	Pct.
Buy	366	48	Buy	97	27
Hold	304	39	Hold	49	16
Sell	54	7	Sell	4	7
Coverage Suspended	33	4	Coverage Suspended	11	33
Rating Suspended	13	2	Rating Suspended	2	15

Issuer-Specific Disclosures (as of May 07, 2020)

Price Charts



Ratings Key

B	Buy	OP	Outperform	L	Long	CS	Coverage Suspended
H	Hold	IL	In Line	NP	No Position	RS	Rating Suspended
S	Sell	UP	Underperform	S	Short		

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